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No. 97-1868

IN THE
# Supreme Court of the United States
OCTOBER TERM, 1997

UNUM LIFE INSURANCE COMPANY OF AMERICA,
*Petitioner,*
v.
JOHN E. WARD,
*Respondent.*

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit**

## REPLY BRIEF FOR PETITIONER

*Of Counsel:*
TAMARRA T. RENNICK
Litigation Counsel
UNUM LIFE INSURANCE COMPANY OF AMERICA
2211 Congress Street
Portland, ME 04122
(207) 770-2211

LESLEY C. GREEN
RUSSELL G. PETTI
BANNAN, GREEN & FRANK LLP
555 South Flower Street
44th Floor
Los Angeles, CA 90017
(213) 362-1177

DAVID L. BACON
*Counsel of Record*
BENJAMIN I. DELANCY
CHARLES M. DYKE
THELEN REID & PRIEST LLP
333 So. Grand Avenue
34th Floor
Los Angeles, CA 90071
(213) 621-9800
*Attorneys for Petitioner UNUM Life Insurance Company of America*

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## REPLY BRIEF FOR PETITIONER

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### I. INTRODUCTION

Petitioner, UNUM Life Insurance Company of America ("UNUM"), submits this Reply Brief to respond to the Brief in Opposition and discuss the District of Columbia Circuit's recent decision in *O'Connor v. UNUM Life Ins. Co. of America*, No. 97-5244, 1998 U.S. App. LEXIS 15117 (D.C. Cir. July 7, 1998),[1] filed after the petition for a writ of certiorari. The need to grant certiorari has become even more pressing since UNUM filed its petition. As shown by *O'Connor*, still another appel-

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[1] The *O'Connor* decision is reproduced in full in the Appendix. The defendant in that case will request the D.C. Circuit by August 14, 1998 to stay the mandate pending this Court's disposition of the certiorari petitions in *Ward* and in *Cisneros v. UNUM Life Ins. Co. of America*, 135 F.3d 1276 (9th Cir. 1998), petition for cert. filed, 66 U.S.L.W. 3773 (U.S. May 20, 1998) (No. 97-1867).

late court has filed a decision deepening the acknowledged Circuit conflict over the standard for application of ERISA's "saving" clause for state insurance regulation.

## II. THE WRIT SHOULD BE GRANTED BASED ON HIGHLY-SIGNIFICANT, IRRECONCILABLE CIRCUIT CONFLICTS.

### A. The Circuits Are In Sharp Conflict Over The Standards For Application Of ERISA's Preemption And "Saving" Clauses.

As shown by the petition, one of ERISA's chief purposes is to bar state laws that "*mandate*[] employee benefit structures or their *administration*," "*prohibit*" what is "permitted" by federal law, "preclude *uniform administrative practice*," or provide *"alternate enforcement mechanisms." New York State Conf. of Blue Cross-Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645 (1995) (emphasis added). The standards for application of ERISA's preemption and "saving" clauses involve highly significant, recurring issues affecting all ERISA plans across the nation. These issues impact an enormously wide variety of state rules including "notice-prejudice," as reflected by the *Ward, Cisneros* and *O'Connor* decisions, as well as numerous others such as "agency," as reflected by *Ward*, "ambiguity," "unreasonableness," "adhesion contract" "rolling accruals" for statute of limitations, and "bad faith" claims-handling rules. The list has no limits.

In applying the "*Elfstrom*" agency law rule,[2] the Ninth Circuit in *Ward* adopted an extraordinarily narrow standard for ERISA preemption, one that cannot be squared with the plain language of ERISA or Congress' key objectives. If a state law rule dealing with fiduciary conduct, governing plan administration and requiring the payment of plan benefits—the very core of ERISA—does not have a "connection with" an ERISA plan triggering preemption

[2] *Elfstrom v. New York Life Ins. Co.*, 67 Cal.2d 503 (1967).



under ERISA § 514(a), *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41 (1987), and *Ingersoll-Rand Co. v. McClendon*, 498 U.S. 133, 139 (1990) (ERISA preempts where "the existence of a . . . plan is a critical factor in establishing liability under state law"), then the preemption clause has absolutely no meaning, a result Congress could not have intended. 29 U.S.C. § 1144(a). At the same time, the District of Columbia and Ninth Circuits have also adopted an extraordinarily broad "saving" clause standard that cannot be squared with ERISA's plain language or Congress' main goals. The courts' simultaneous contraction of the preemption clause to a virtual nil, and their correspondingly large expansion of the "saving" clause, have the net effect of resurrecting state law as the primary vehicle for regulating the fiduciary standards, plan administration and civil enforcement for all ERISA plans. This will produce the crazy quilt of conflicting plan rules across the land that ERISA was enacted to eliminate. ERISA § 514(a); *Pilot Life, supra; Ingersoll-Rand, supra.* Additionally, both the new ERISA preemption and "saving" clause standards will produce results 180 degrees at variance to the standards adopted by the other Circuits which have followed ERISA's statutory scheme. Consequently, the employee benefit laws and rules for plan administration in California, Arizona and the District of Columbia, for example, now differ markedly from those in Texas, Florida, Illinois, Kansas and dozens of other states.

At present, the Ninth and Seventh Circuits have divided over whether ERISA's preemption standard allows state law common-law agency claims to control fiduciary standards, plan administration and benefit payments.[3] More-

[3] *Ward, supra,* and *Jass v. Prudential Health Care Plan*, 88 F.3d 1482, 1488-1490 (7th Cir. 1996) (ERISA preempts state law agency claims related to a denial of benefits). Mr. Ward's attempt to extinguish this conflict by contending that the *Ward* decision involved only whether oral notice to the plan sponsor can be a substitute for the plan's requirement for written notice to the plan

over, decisions in seven Circuits have held that either all three McCarran-Ferguson factors must be satisfied for ERISA's "saving" clause to apply,[4] or at the very least the first factor—the transfer of risk of loss—must be met.[5] Conversely, courts in three Circuits have held that all three factors are not required.[6] The *O'Connor* decision thus increases to ten the Circuits divided over this key "saving" clause issue.

In short, vastly different holdings as to the ERISA pre-emption and "saving" clause standards have now placed the great majority of Circuits in irreconcilable conflicts over issues that are central to the administration of the nation's employee benefit plan system. These are highly-significant conflicts which affect the entire country and can only be resolved by this Court.

### B. The *O'Connor* Decision Not Only Deepens The Conflicts, But Also Clashes With ERISA's Statutory Scheme.

In *O'Connor*, the District of Columbia Circuit, extending the acknowledged conflict still farther, held that ERISA "saves" a state common-law rule of general application even though it not only directly impacted plan administration and benefit payment, but also failed to satisfy all three

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fiduciary is transparently incorrect. The ERISA regulations contemplate the filing of *written* claims with the insurance company. 29 C.F.R. § 2560.503-1(c)-(d). Moreover, the Ninth Circuit's holding was not so limited; rather, by citation to *Elfstrom*, it subjects the relationship between the plan sponsor and the fiduciary to *all* aspects of California agency law.

[4] *CIGNA Healthplan v. Louisiana*, 82 F.3d 642, 650 (5th Cir.), *cert. denied*, 117 S.Ct. 387 (1996); *Tingle v. Pacific Mut. Ins. Co.*, 996 F.2d 105, 108 (5th Cir. 1993); *Anschultz v. Connecticut Gen'l Life Ins. Co.*, 850 F.2d 1467, 1468-1469 (11th Cir. 1988).

[5] *See* decisions cited in the petition at page 10, note 6.

[6] *Cisneros, supra; O'Connor, supra; Ward, supra; Davies v. Centennial Life Ins. Co.*, 128 F.3d 934, 940 (6th Cir. 1997).



McCarran-Ferguson criteria for the "business of insurance." Indeed, the rule did not even involve the transfer of the risk of loss, which this Court has described as an " 'indispensable characteristic of insurance' " [7] *See also Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25, 39 (1996) (the spreading of risk lies "at the core of . . . McCarran-Ferguson . . . concerns").

Essentially, *O'Connor*, following in the Ninth Circuit's footsteps, attempted to reduce the standard for application of ERISA's "saving" clause to the simplicity of the rhetorical question posed by *Cisneros*, "If California's rule does not regulate insurance, what does it regulate?" [8] As shown below, ERISA's carefully-crafted statutory framework is simply incompatible with the extraordinary variety of common-law rules of general application preserved by these "saving" clause holdings. The *Ward* pre-emption standard is also wholly foreign and destructive to ERISA's statutory scheme. In conflict with other Circuits, these three decisions pry open the administration of both self-funded and insured ERISA plans—an area intended to be " 'exclusively a federal concern,' " *Pilot Life*, 481 U.S. at 45-46 (citation omitted)—to virtually unlimited state common-law regulation, the exact opposite of ERISA's statutory regimen and Congress' objectives. All of this highlights the need for immediate review by this Court.

The *O'Connor* decision—similar to *Cisneros* and *Ward*—first overlooks the fact that the California "notice-prejudice" rule is nothing more than a basic principle of contract law which applies in *all* contracts, not merely insurance policies. Parties to all contracts have a duty to cooperate, including a duty with respect to notices, *see Restatement (2d) of Contracts*, § 205, and illustration 7

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[7] *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 211-213 (1979).

[8] *Cisneros*, 134 F.3d at 946.

(insurance policy notice and proof of loss provisions subject to duty to cooperate), with only a *prejudicial* breach relieving the other party of its duty to perform.[9] This contract rule applies not only to insurance contracts, *Campbell v. Allstate Ins. Co.*, 60 Cal.2d 303 (1963) ("notice-prejudice" rule based on "cooperation" clause in insurance contract), but also to *every* contract in California. *Universal Sales Corp. v. California Press Mfg. Co.*, 20 Cal.2d 751 (1942) (the duty to cooperate exists "[i]n every contract.") Unlike the mandated-benefits statute in *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724 (1985), the California rule involving "notices" admittedly does not transfer the risk of loss; it is not unique to the insurance industry; it only purports to "regulate[] the *administration* of policies, *not* their substantive terms";[10] and it merely shifts the legal risks that would arise when a claim for plan benefits is asserted under the contract.

The California "notice-prejudice" rule, therefore, is no more specific to the insurance industry, nor satisfies the McCarran-Ferguson criteria, that the Mississippi law of "bad faith" addressed in *Pilot Life*, 481 U.S. at 49-50. Even though the Mississippi Supreme Court had "*identified* its law of bad faith with the insurance industry," this Court concluded that the "*roots* of this law" were

[9] *Aetna Cas. and Surety Co. v. Murphy*, 206 Conn. 409, 538 A.2d 219 (1988) (justifying adoption of "notice-prejudice" rule on general contract principle of avoiding a disproportionate forfeiture); *Smith, Valentino & Smith, Inc. v. Superior Court of Los Angeles Cty.*, 17 Cal. 3d 491, 497 (1976) (prior breach may be *de minimis*).

[10] *See Smith v. Jefferson Pilot Life Ins. Co.*, 14 F.3d 562, 570 (11th Cir.) (ERISA preempts statute requiring notice for cancellation of insurance coverage to be effective) (emphasis added), *cert. denied*, 513 U.S. 808 (1994); *Davies v. Centennial Life Ins. Co.*, 128 F.3d 934, 942 (6th Cir. 1997) (ERISA preempts statute permitting rescission of insurance policy in case of willful misrepresentation by plan participant; "saving" clause not applicable because statute does not spread risk or "affect the substantive terms" of the insurance contract).



"firmly planted in the general principles of Mississippi tort and contract law." *Id.* at 49-50 (emphasis added). Consequently, it held that the state law did not pass the "common sense" test for "regulating insurance." *Id.* Further, it held that the law did not satisfy all of the McCarran-Ferguson criteria because it failed to involve the transfer of risk of loss, was "no more 'integral' to the insurer-insured relationship than any State's general contract law," and was not unique to the insurance industry. *Id.* at 50-51. California's rule involving "notices" is exactly parallel. While often "identified" with insurance cases, the doctrine has its roots in and is merely part of a general principle of contract law applicable to all California contracts. Moreover, had Congress intended to include such rules of general application within the insurance exception, it could have easily so provided as it did in ERISA § 514(b)(4) by excepting "any *generally applicable* criminal law of a State" from ERISA's preemption provision. *See* 29 U.S.C. § 1144(b)(4) (emphasis added).

The *O'Connor* decision also overlooks the fact that even if the California "notice-prejudice" rule could somehow be deemed a law "regulating insurance," it directly impacts plan administration, fiduciary responsibility and suits for the payment of benefits and, accordingly, would be preempted under conflicts preemption analysis for two closely-related reasons. First, the rule directly conflicts with ERISA's substantive provisions governing fiduciary standards, claims-processing and payment, plan administration, and clashes with its exclusive civil enforcement scheme. ERISA §§ 401-404, 502(a)(1)(B)-503, 29 U.S.C. §§ 1101-1114, 1132(a)(1)(B)-1133; 29 C.F.R. § 2560.503-1; *Pilot Life*, 481 U.S. at 50-57; *Ingersoll-Rand*, 498 U.S. at 139. Second, the rule is preempted by the joint application of McCarran-Ferguson and ERISA's "saving" clause for pre-existing federal laws. ERISA does not "alter . . . invalidate . . . or supersede

any law of the United States. . . .," [11] one such pre-existing law being McCarran-Ferguson. *See Metropolitan Life*, 471 U.S. at 744 n.21. Consistent with federal supremacy principles, McCarran-Ferguson provides that federal legislation which "specifically relates" to the business of insurance will displace any conflicting state law. 15 U.S.C. § 1012(b).

If, as the *O'Connor* court held, a state common-law rule which directly impacts claims-processing, plan administration and suits for benefits "regulates the relationship between insurer and insured" (App. at 9a), then *a fortiori* ERISA also "specifically relates" to the business of insurance in this context and therefore preempts state law pursuant to 15 U.S.C. § 1012(b). As shown above, ERISA directly governs fiduciary standards, claims-proccessing and payment and plan administration, while providing an *exclusive* civil enforcement scheme. *See Pilot Life, supra; John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank*, 510 U.S. 86, 99-100 (1993) (ERISA preempts state regulation of the "business of insurance" if it presents a "direct conflict" with federal law or "stands as an obstacle to the accomplishment of the full purposes and objectives of Congress" (citation omitted)).

The *O'Connor* decision thus not only deepens the acknowledged Circuit conflict on the standard for application of ERISA's "saving" clause, but also underscores the exact reasons why this Court should swiftly intervene over the welter of conflicting decisions on the preemption and "saving" clause standards. The policy reasons which gave rise to ERISA include the need for interstate employers to have a uniform, federal employee benefits law, and to be able to administer their plans the same way in all 50 states. *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 105 (1983); *Pilot Life, supra*; ERISA § 2, 29 U.S.C.

[11] ERISA § 514(d), 29 U.S.C. § 1144(d).



§ 1001. These policy grounds are even more pressing in this era of telecommuting and virtual offices, an era which has seen the workplace itself rapidly become *national* in scope. The *Ward, Cisneros* and *O'Connor* decisions both undermine these central goals embodied in ERISA and throw the Circuits into significant conflicts nationwide which only this Court can resolve.

### C. The Decision Below Is Not Interlocutory.

Mr. Ward's first premise—without citation of authority—that the "*Efstrom*" agency law holding is a "contingent alternative holding in an interlocutory case" is plainly wrong. The Ninth Circuit's holding that ERISA does not preempt state agency law directly impacting plan administration and benefit payment because the state law somehow fails to have a "connection with" the plan is final and conclusive no matter how wrongly decided. Even a district court's remand of an ERISA matter to the plan administrator is a final and appealable judgment under 28 U.S.C. § 1291, rather than an "interlocutory" order under § 1292. *See Snow v. Standard Insurance Co.*, 87 F.3d 327, 330 (9th Cir. 1996) (taking jurisdiction of a remand order in an ERISA case as a final judgment under § 1291).[12]

Mr. Ward's second argument, that the Ninth Circuit's agency law holding is not certain to be applied, is both irrelevant and incorrect. This startling decision that state agency law not only governs the relationship between a plan fiduciary and the plan sponsor serving as administrator, notwithstanding ERISA's own comprehensive regulation of fiduciary conduct,[13] but also may require the

[12] The treatment of a remand order as a final judgment is consistent with *Sullivan v. Finkelstein*, 496 U.S. 617, 625 (1990) (district court's decision invalidating Social Security regulations and remanding for a benefits determination was "unquestionably" a "judgment").

[13] ERISA §§ 401-414, 503, 29 U.S.C. §§ 1101-1114, 1133.

fiduciary to pay benefits contrary to the plan's written terms, is final and conclusive on the agency law issue. *See Herrington v. County of Sonoma*, 706 F.2d 938, 939 (9th Cir. 1983) (lower court's abstention ruling was a "final decision" because "the impact here was to send [plaintiff] effectively out of court" (citation omitted)). This agency law decision applies immediately to all ERISA plans throughout the Ninth Circuit and, accordingly, it warrants immediate review.

## CONCLUSION

In view of the increasingly wide-spread Circuit conflicts over the standards for application of ERISA's preemption and "saving" clauses, the "centrality of pension and welfare plans in the national economy," *Boggs v. Boggs*, 117 S.Ct. 1754, 1760 (1997), and the great significance of these issues, petitioner urges that the writ of certiorari be granted.

Respectfully submitted,

*Of Counsel:*
TAMARRA T. RENNICK
Litigation Counsel
UNUM LIFE INSURANCE COMPANY OF AMERICA
2211 Congress Street
Portland, ME 04122
(207) 770-2211

LESLEY C. GREEN
RUSSELL G. PETTI
BANNAN, GREEN & FRANK LLP
555 South Flower Street
44th Floor
Los Angeles, CA 90017
(213) 362-1177

August 3, 1998

DAVID L. BACON
*Counsel of Record*
BENJAMIN I. DELANCY
CHARLES M. DYKE
THELEN REID & PRIEST LLP
333 So. Grand Avenue
34th Floor
Los Angeles, CA 90071
(213) 621-9800
*Attorneys for Petitioner UNUM Life Insurance Company of America*

# APPENDIX

**APPENDIX**

**UNITED STATES COURT OF APPEALS**
**FOR THE DISTRICT OF COLUMBIA CIRCUIT**

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No. 97-5244

MARY O'CONNOR,
*Appellant*

v.

UNUM LIFE INSURANCE COMPANY OF AMERICA,
*Appellee*

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April 17, 1998, Argued
July 7, 1998, Decided

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Appeal from the United States District Court
for the District of Columbia
(No. 96cv02158)

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Before: WILLIAMS, GINSBURG, and GARLAND, Circuit Judges. Opinion for the Court filed by Circuit Judge GINSBURG.

**OPINION**

GINSBURG, Circuit Judge: Mary O'Connor sued her former employer and its insurance company for their failure to pay long-term disability benefits under an employee benefit plan. The district court dismissed the case against the insurance company because O'Connor

failed to submit timely proof of her claim, and transferred the case against the employer (and the receiver thereof) to the Central District of California. For the reasons stated below we reverse.

## I. Background

Western Federal Savings and Loan Association provided its employees with a long-term disability benefit plan insured by the UNUM Life Insurance Company of America and governed by the Employee Retirement Income Security Act, 29 U.S.C. § 1001 *et seq.* Under the terms of the plan an injured employee must give UNUM written notice of any claim "within 30 days of the date disability starts, if that is possible" or else "as soon as it is reasonably possible to do so." In addition, the employee must provide proof of the claim "no later than 90 days after the end of the elimination period," which ends 180 days after the onset of the disability, or else "as soon as reasonably possible," but in no event more than "one year after the time proof is otherwise required." Therefore, the latest an employee may file a timely proof of claim is 270 days plus one year after the onset of her disability.

In 1991 O'Connor was an assistant manager in a Northern California branch office of Western Federal, which had its principal place of business in Southern California. In July 1991 O'Connor became disabled, took a leave of absence, and received workers' compensation benefits. Western Federal terminated her employment effective August 7, 1992.

O'Connor contends that despite her asking repeatedly whether she was entitled to additional benefits Western Federal never told her about the long-term disability plan. Nor did O'Connor ever receive a summary plan description, as required by the ERISA.



In early 1993 O'Connor learned from a friend about the long-term disability plan. On March 18 of that year O'Connor submitted a notice of claim to Western Federal and sent the physician statement portion of the proof-of-claim form to her doctor, who forwarded the completed form to Western Federal in May. UNUM received the proof-of-claim form in mid-May, 42 or 43 days late. In July UNUM informed O'Connor of its final decision to deny her claim because she had not filed the proof of claim within the time limit set by the plan.

Meanwhile, in June 1993 the United States had placed Western Federal into receivership, and the Resolution Trust Corporation had been appointed receiver. Subsequently, the Federal Deposit Insurance Corporation succeeded the RTC as receiver.

In September 1995 O'Connor filed suit against UNUM, Western Federal, and the receiver in the United States District Court for the Northern District of California. The FDIC moved to dismiss and in September 1996 the court held that the case was in the wrong venue because a claim against the FDIC as receiver must be filed in either the district in which the depository institution had its principal place of business (in this case the Central District of California), or in the District of Columbia. *See* 12 U.S.C. § 1821(d)(6). Based upon O'Connor's preference the case was transferred from the Northern District of California to the District of Columbia.

After the transfer, however, O'Connor moved to retransfer the case back to the Northern District of California; if venue was not proper there for a case against the FDIC, then O'Connor invited the court to dismiss the FDIC as a party. In opposition UNUM argued that it was planning to move for summary judgment and that in the interest of judicial economy the court should decide its motion before deciding O'Connor's motion to retransfer. In August 1997 the district court

granted UNUM's motion for summary judgment, holding that

> the terms of UNUM's disability benefits policy are clear and unambiguous, and . . . pursuant to the policy's terms, plaintiff was required to file her proof of claim for long term disability benefits by no later than April 7, 1992 . . . and failed to do so.

The court thereupon transferred the case against the FDIC to the Central District of California, and O'Connor appealed.

## II. Analysis

O'Connor's primary argument is that the district court erred in granting summary judgment to UNUM because UNUM failed to submit any evidence that it was prejudiced by O'Connor's failure to file timely proof of her claim. Here O'Connor relies upon the so-called "notice-prejudice" rule of California, which provides:

> [A] defense based on an insured's failure to give timely notice [of a claim] requires the insurer to prove that it suffered substantial prejudice. Prejudice is not presumed from delayed notice alone. The insurer must show actual prejudice, not the mere possibility of prejudice.

*Shell Oil Co. v. Winterthur Swiss Ins. Co.*, 12 Cal. App. 4th 715, 15 Cal. Rptr. 2d 815, 845 (Cal. Ct. App. 1993) (citations omitted); see *Clemmer v. Hartford Ins. Co.*, 22 Cal. 3d 865, 587 P.2d 1098, 1106-07, 151 Cal. Rptr. 285 (Cal. 1978) (in banc). UNUM argues not that it suffered substantial prejudice, but rather that the notice-prejudice rule is preempted by the ERISA.

The ERISA provides broadly for the preemption of "all Sate laws insofar as they may now or hereafter relate to any employee benefit plan described in section 1003(a) of this title," 29 U.S.C. § 1144(a), subject to certain



exceptions. An exception is to be found in the "saving" clause for "any law of any State which regulates insurance, banking, or securities." *Id.* § 1144(b)(2)(A).

The parties agree that the notice-prejudice rule "relates to an[] employee benefit plan" covered by the ERISA, *id.* § 1144(a), and therefore falls within the general preemption provision of the ERISA. What they dispute is whether the saving clause applies.

In *Pilot Life Insurance Co. v. Dedeaux*, 481 U.S. 41, 48, 95 L. Ed. 2d 39, 107 S. Ct. 1549 (1987), the Supreme Court described the test by which we are to determine whether a state law "regulates insurance" within the meaning of the saving clause: Take a "common-sense view" of the term "regulates insurance," and look to the three factors the Court has previously identified for determining whether an activity comes within the "business of insurance" as that term is used in the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015. The three factors are:

> "First, whether the practice has the effect of transferring or spreading a policyholder's risk; second, whether the practice is an integral part of the policy relationship between the insurer and the insured; and third, whether the practice is limited to entities within the insurance industry."

*Pilot Life*, 481 U.S. at 48-49 (quoting *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129, 73 L. Ed. 2d 647, 102 S. Ct. 2002 (1982)); see *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 742-44, 85 L. Ed. 2d 728, 105 S. Ct. 2380 (1985).

Applying these factors to a similar long-term disability benefit plan issued by UNUM the Ninth Circuit, in *Cisneros v. UNUM Life Insurance Co. of America*, 134 F.3d 939 (1998), pet. for cert. filed, 66 U.S.L.W. 3773 (U.S. May 20, 1998) (No. 97-1867), held that the California notice-prejudice rule comes within the saving clause of,

and therefore is not preempted by, the ERISA. After first agreeing with UNUM that the employee in that case had failed to comply with the unambiguous deadline for submitting a proof of claim. *id.* at 943, the Ninth Circuit rejected UNUM's argument that the ERISA preempted the notice-prejudice rule and reversed summary judgment in favor of UNUM because the insurer had not shown substantial prejudice from the delay.

The Cisneros court held that the notice-prejudice rule was not preempted specifically because it is covered by the saving clause. With respect to the "common sense part of the test laid out in Pilot Life, the court stated:

> By requiring the insurer to prove prejudice before enforcing proof-of-claim requirements, the notice-prejudice rule dictates the terms of the relationship between the insurer and insured and so seems, as a matter of common sense, to "regulate insurance." The rule is directed specifically at the insurance industry and is applicable only to insurance contracts.

*Id.* at 945. With respect to the McCarran-Ferguson factors, the court held that the first factor did not favor saving the notice-prejudice rule because "it does not alter the allocation of risk for which the parties initially contracted, namely the risk of lost income from long-term disability." *Id.* at 946.* The second and third factors, however, "weighed heavily in favor" of saving the notice-prejudice rule, respectively because that rule "dictates the terms of the relationship between the insurer and the insured, and consequently, is integral to that relationship," and because it "applies only to the insurance industry." *Id.*

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* O'Connor does not argue that the notice-prejudice rule has the effect of transfering or spreading a policyholder's risk. Therefore, while we adopt the reasoning of Cisneros, we have no occasion in this case to decide whether Cisneros was correct upon that point.



The court concluded that although only two of the three McCarran-Ferguson factors favored saving the notice-prejudice rule from preemption, on balance that was enough.

> We can find no sense in concluding that this particular state law does not regulate insurance when it so clearly does. If California's rule does not regulate insurance, what does it regulate? A rote application of the risk spreading factor would work unreasoned mischief against the broad purpose of the saving clause, eliminating California's notice-prejudice insurance rule from its reach.

*Id.*

UNUM's primary argument against applying the notice-prejudice rule here is that a state law "regulates insurance" within the meaning of the saving clause only if all three McCarran-Ferguson factors favor that characterization—a position that the Fifth Circuit has expressly adopted, see, e.g., *Cigna Healthplan of La., Inc. v. Louisiana*, 82 F.3d 642, 650 (5th Cir. 1996); *Tingle v. Pacific Mut. Ins. Co.*, 996 F.2d 105, 107, 110 (5th Cir. 1993), and the Eleventh Circuit has implicitly followed, see *Anschultz v. Connecticut Gen. Life Ins. Co.*, 850 F.2d 1467, 1469 (11th Cir. 1988) (holding that statute "fails to satisfy all of the criteria of the McCarran-Ferguson Act and, thus, falls outside the ERISA saving clause"); cf., e.g., *Brewer v. Lincoln Nat'l Life Ins. Co.*, 921 F.2d 150, 153 (8th Cir. 1990) (common-law rule of contract interpretation not saved because it failed two factors); *Howard v. Gleason Corp.*, 901 F.2d 1154, 1158-59 (2d Cir. 1990) (insurance notice statute not saved because it failed common sense test and two of three factors); *Kelley v. Sears, Roebuck & Co.*, 882 F.2d 453, 456 (10th Cir. 1989) (unfair practices statute not saved because it failed two of three factors). In addition, UNUM relies upon *Group Life & Health Insurance Co. v. Royal Drug Co.*,

440 U.S. 205, 59 L. Ed. 2d 261, 99 S. Ct. 1067 (1979) (holding that agreements between insurer and pharmacies setting price of prescriptions is not "business of insurance" within McCarran-Ferguson Act for purpose of exemption from antitrust laws), for the proposition that the first factor—whether the rule transfers or spreads a policyholder's risk—is the most important.

These two related arguments are not persuasive. We think the better reading of the Supreme Court's McCarran-Ferguson Act cases is that none of the factors in the test is by itself determinative of what constitutes the business of insurance. Certainly nothing in Royal Drug means that any practice outside the core risk-spreading functions of insurance—such as requiring notice and proof of a claim —cannot still be a part of the "business of insurance." Indeed, in the subsequent antitrust case in which the three-factor test first appears, the Court clearly stated, albeit in a dictum, that "none of these criteria is necessarily determinative in itself." *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129, 73 L. Ed. 2d 647, 102 S. Ct. 3002 (1982). Similarly, in Metropolitan Life, where the Court first applied the McCarran-Ferguson test in order to determine whether a state law "regulates insurance" for the purpose of the ERISA saving clause, the three factors were said to be "relevant" to the question whether a state law is a regulation of the "business of insurance." 471 U.S. at 743. That the factors are merely "relevant" suggests that they need not all point in the same direction, else they would be "required."

Moreover, because the notice-prejudice rule so clearly passes the common sense part of the test set out in Metropolitan Life, we think it would be unreasonable to hold that the rule does not regulate the business of insurance because it does not transfer or spread a policyholder's risk. As the Ninth Circuit asked rhetorically in Cisneros, "if California's rule does not regulate insurance, what does



it regulate?" Furthermore, the second McCarran-Ferguson factor strongly supports the conclusion that the notice-prejudice rule regulates the business of insurance; the rule directly regulates the relationship between insurer and insured, which the Supreme Court has indicated is the "focus" of the term "business of insurance" in the McCarran-Ferguson Act. "Statutes aimed at protecting or regulating this relationship, directly or indirectly, are laws regulating the 'business of insurance.'" *SEC v. National Securities, Inc.*, 393 U.S. 453, 460, 21 L. Ed. 2d 668, 89 S. Ct. 564 (1969).

UNUM argues next that two other courts of appeals have held that ERISA preempts state notice rules, here referring to *Nazay v. Miller*, 949 F.2d 1323 (3d Cir. 1991), and *Howard v. Gleason Corp.*, 901 F.2d 1154 (2d Cir. 1990). Although the court in Nazey did hold that the district court improperly imported a state prejudice rule into the notice requirement of a health insurance plan, see 949 F.2d at 1336-37, the opinion addresses neither the preemption nor the saving provisions of the ERISA. In Howard the court determined that the state rule at issue fell outside the saving clause largely because it applied both to insurers and to employers, see 901 F.2d at 1158-59; the notice-prejudice rule of California, however, applies only to insurers. Therefore, neither Nazay nor Howard controls this case.

Finally, UNUM relies upon six cases upholding the decisions of insurers not to provide benefits to employees who failed to file timely proof of their claims. In four of the cases UNUM cites there was no issue of preempting a state noticeprejudice or similar rule. See *Shealy v. UNUM Life Ins. Co. of Am.*, 979 F. Supp. 395 (D.S.C. 1997), aff'd mem., ——— F.3d ———, 1998 U.S. App. LEXIS 8820, 1998 WL 231258 (4th Cir. 1998); *Lehmann v. UNUM Life Ins. Co. of Am.*, 916 F. Supp. 897 (E.D. Wis. 1996); *Ken-*

*nedy v. System One Holdings, Inc.*, 835 F. Supp. 947 (S.D. Tex. 1993); *Freeman v. UNUM Life Ins. Co.*, 1990 WL 640294 (D. Minn. Mar. 27, 1990). In the other two cases the courts dismissed almost entirely without analysis the arguments that state law required a showing of prejudice. See *Oas v. Royal MacCabees Life Ins. Co.*, 1995 U.S. Dist. LEXIS 16841, 1995 WL 664640, at *7 (E.D. Pa. Nov. 6, 1995) (citing Nazay and stating that there the Third Circuit "rejected the idea of an Insurance Company having to establish some sort of prejudice"), aff'd mem., 92 F.3d 1172 (3d Cir. 1996); *Mackey v. UNUM Life Ins. Co. of Am.*, No. C86-5265, at 5 (W.D. Wash. May 12, 1987) ("State law is inapplicable in this ERISA case"). Therefore these cases do not alter our conclusion.

III. Conclusion

We hold that the ERISA does not preempt the notice-prejudice rule of California. Therefore, because UNUM did not provide evidence of substantial prejudice the district court erred when it granted UNUM's motion for summary judgment. Accordingly we remand this matter for the district court to determine whether, with UNUM still a defendant, the case should stay in the District of Columbia or be transferred elsewhere.

So ordered.